

**Education Audit Appeals Panel
State of California**

Appeal of Certain Audit Findings for Fiscal Years 2002-03, 2003-04, and 2004-05, by: Options for Youth – Burbank, Inc; San Gabriel, Inc.; Upland, Inc.; and Victor Valley, Inc.,	EAAP Case No. 06-18 OAH No. L2006100966
Appeal of Certain Audit Findings for Fiscal Years 2001-02, by: Options for Youth – Burbank, Inc; San Gabriel, Inc.; Upland, Inc.; and Victor Valley, Inc.,	EAAP Case No. 07-07 OAH No. 2007060722
Appeal of Certain Audit Findings for Fiscal Years 2002-03, 2003-04, and 2004-05, by: Opportunities for Learning – BP (Baldwin Park), LLC; C (Charter), LLC; and WSH (Santa Clarita), LLC,	EAAP Case No. 06-19 OAH No. L2006110025
Appeal of Certain Audit Findings for Fiscal Years 2001-02, by: Opportunities for Learning – BP (Baldwin Park), LLC; C (Charter), LLC; and WSH (Santa Clarita), LLC, Appellant.	EAAP Case No. 07-08 OAH No. 2007060728

Decision

The Education Audit Appeals Panel has adopted the attached Proposed Decision of the Administrative Law Judge as its Decision in the above-entitled matter.

Effective date: March 3, 2014.

IT IS SO ORDERED.

March 3, 2014

Date

Original Signed

David Botelho, Chairperson
for Education Audit Appeals Panel

**BEFORE THE
EDUCATION AUDIT APPEALS PANEL
STATE OF CALIFORNIA**

In the Matter of the Consolidated Audit of
Appeals of:

OPTIONS FOR YOUTH, et al., and
OPPORTUNITIES FOR LEARNING, et al.,

Appellants,

vs.

STATE CONTROLLER'S OFFICE,

Respondent,

and

CALIFORNIA DEPARTMENT OF
EDUCATION, CALIFORNIA STATE
BOARD OF EDUCATION, AND
CALIFORNIA DEPARTMENT OF
FINANCE,

Interveners.

OAH Nos. L 2006100966
L 2006110025
L 2007060728
L 2007060722

EAAP Nos. 06-18
06-19
07-08
07-07

CORRECTED PROPOSED DECISION

The above captioned matters were consolidated and were heard by Humberto Flores, Administrative Law Judge with the Office of Administrative Hearings in Los Angeles, California. The hearing consisted of two phases. Phase I of this hearing was held on February 20, 21 and 22, 2008. The Phase II was heard on January 8, 9, 10, 11, 14 and 16, 2013.

Following Phase II of the hearing, Interveners and Appellants filed proposed Factual Findings and Legal Conclusions and lodged official transcripts of the hearing. The record was closed and the matter was deemed submitted on October 21, 2013.

Deputy Attorneys General Ernest Martinez, John Venegas, and Phillip Matsumoto appeared on behalf of Interveners California Department of Finance (CDF), California Department of Education (CDE), and the State Board of Education (SBE).

Gregory M. Bordo and Kathy PourSanae of Blank Rome, LLP appeared on behalf of Appellants Options for Youth (OFY) and Opportunities for Learning (OFL).

The State Controller, who is the statutory Respondent, has not actively participated or appeared in either the Phase I or Phase II hearings.

On February 3, 2014, the undersigned received an Application for Minor and Technical Changes to the proposed decision issued on January 3, 2014. The request was made by Timothy Morgan, Staff Attorney for the Education Audit Appeals Panel, pursuant to California Code of Regulations, title 1, section 1048, subdivision (a). The following changes were requested:

- (1) In paragraph 8 on page 5, insert “and” in the name “Fiscal Crisis and Management Team.”
- (2) In paragraph 40 on page 13, correct the overpayment attributed to OFL-Baldwin Park to read \$1,183,641 consistent with the Extraordinary Audit Report and the total of \$3,636,737 (in paragraph 44 on page 14) that includes the mistyped number.
- (3) Clarify the last sentence of paragraph 49 on page 15 to read “The EAAP concluded that it had no authority to determine whether a charter school may be required to repay any amount based on a change in . . . the charter school’s SB 740 funding determination level.”
- (4) In paragraph 53 on page 16, delete “to” before the S.B. 740 related fundings.”
- (5) In paragraph 61 on page 18, insert the missing words in the quotation from the pre-2001 version of Education Code section 47612, subdivision (b), as follows: “(b) Notwithstanding any other provision of law, a charter school that provides independent study shall comply with Article 5.5 (commencing with section 51745) of Chapter 5 of Part 28 and implementing regulations adopted thereunder.”
- (6) In paragraph 74 on page 23, insert the missing words “instruction in” in the quotation of Regulation 11963.1 between “nonclassroom-based” and “charter schools.”
- (7) In paragraph 80 on page 24, delete “47634.2” from the Education Code sections cited in the first sentence [The focus of Section 47634.2 is the process for settling funding determination percentage, rather than factors related to that process, such as pupil-to-teacher ratio, that have impacts apart from their possible relevance to the SBE’s funding determination.]
- (8) In paragraph 82 on page 25, insert “was” between “Appellant OFL and “overfunded.”

None of the parties filed written opposition to the Application within 10 days. The Application for Minor and Technical Changes is granted in part. The changes requested in numbers 1, 2, 4, 5, 6, and 8 of the Application are granted and have been made in this corrected proposed decision. These requested changes relate to errors in the proposed

decision that are clearly minor, typographical or technical. The undersigned does not consider the requested changes in numbers 3 and 7 as minor, typographical or technical. Therefore, these requested changes are denied.

INTRODUCTION AND PROCEDURAL BACKGROUND

Appellants OFY and OFL operate a number of non-classroom-based charter schools throughout California. Charter schools in this state are governed by the Charter School Act, which is set forth in Education Code section 47600 et seq.

In March 2005, the California Department of Education (CDE), along with certain county offices of education, initiated an investigative audit of certain OFY and OFL charter schools. MGT of America, Inc. (MGT), the firm that performed the audit, issued an Extraordinary Audit Report (EAR) on August 9, 2006. The EAR covers the three fiscal years of 2002-03 through 2004-05, and consists of four separate chapters, with apportionment significant findings and recommendations in Chapters 3 and 4 of said audit. The auditors issued a Follow-Up Audit Report on April 11, 2007. The Follow-Up Audit covered the fiscal year of 2001-02, and included findings and recommendations. OFL and OFY appealed the findings and recommendations of the EAR and the Follow-Up Audit. The parties agreed that the issues raised in Chapter 2 would not be litigated in these proceedings.

The investigative audits were commissioned by the California State Superintendent of Public Instruction in cooperation with the Los Angeles, Orange, Sacramento, San Bernardino, and Siskiyou County Offices of Education.

The issue litigated in Phase I was whether Appellants were overfunded by more than \$34 million as a result of alleged incorrect Full-Time-Equivalent (FTE)¹ calculations for the determination of pupil-to-teacher ratios (PTR) to determine the amount of state funding based on average daily attendance (ADA).

The ALJ issued Factual Findings and Legal Conclusions after completion of Phase I. Interveners filed a Motion for Reconsideration and on March 3, 2011, the undersigned issued Factual Findings and Legal Conclusions for Phase I after Reconsideration.

Phase II addressed all other issues of the appeals of the EAR and the Follow-Up Audit Report. Specifically, the Phase II issues are as follows: (1) Whether OFL-Baldwin Park and OFL-Capistrano misclassified expenses reported on the schools' funding determination forms submitted to the state for the 2003/2004 school year and whether they were overfunded \$6,727,317 as a result; (2) to the extent the expenses were misclassified, whether the schools nonetheless substantially complied with their reporting requirements; (3) whether OFL-Baldwin Park, OFL-Capistrano, and OFL-William S. Hart was overfunded \$3,636,737 as a

¹ A full-time equivalent (FTE) is a basic unit of employment for teachers. A teacher who teaches full-time is considered one FTE.

result of incorrect PTR calculations for the fiscal years covered by the EAR; and (4) whether OFL-William Hart was overfunded \$601,271 for the 2001/2002 fiscal year.

After the completion of the evidentiary portion of the hearing, Interveners submitted Exhibit 17, which contains disputed Los Angeles Unified School District (LAUSD) PTR calculations for the fiscal years 2001/2002 through 2004/2005. Exhibit 17 also contains a declaration from Tyler Covey, the lead auditor for MGT, stating that the LAUSD PTR calculations were part of the working papers of the audit. The PTR calculations were obtained by MGT auditors directly from LAUSD personnel and were utilized by the auditors in issuing the EAR and the Follow-up Audit.² Mr. Covey did not bring these working papers to the hearing because he had been informed that Appellants had stipulated that they would not dispute the mathematical computations of the EAR and Follow-up Audit. Appellants objected to Exhibit 17 based on a lack of foundation and that the admission of Exhibit 17 was untimely and prejudicial. In a written ruling, the ALJ overruled Appellants' objection, reopened the record and admitted Exhibit 17 as administrative hearsay pursuant Government Code section 11513, which provides that relevant hearsay evidence may be admitted to support or supplement other evidence. The declaration of Mr. Covey sufficiently lays the foundation for this exhibit as part of the working papers for this audit. The ALJ's ruling also gave Appellants the opportunity to schedule another hearing day to cross-examine Mr. Covey on Exhibit 17. In addition, the ALJ gave each party the opportunity to subpoena and call a representative of the LAUSD to testify regarding the PTR at LAUSD that would be relevant to these proceedings. Appellants chose not to cross-examine Mr. Covey and elected not to call a witness from LAUSD.

This Proposed Decision addresses and decides all of the issues litigated in both phases of the hearing. The Proposed Decision contains certain changes to the legal conclusions set forth in the Factual Findings and Legal Conclusions for Phase I After Reconsideration. Most notably, in place of the current version of California Code of Regulations, title 5, section 11963.4, the legal conclusions herein cite the version of Regulation 11963.4 in effect during the relevant time period of the audit. The findings and legal conclusions herein that address and decide Phase I issues supersede any previous findings, legal conclusions and rulings.

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² The LAUSD PTRs contained in Exhibit 17, were relied upon by MGT in conducting the audit as noted by Mr. Covey during his testimony.

FACTUAL FINDINGS

1. OFY and OFL charter schools receive funding from CDE based on the ADA of the charter schools. Schools may claim ADA based on the aggregate attendance of students during each reporting period. For example, one student who attends school each day for the entire reporting period equals 1.0 ADA. The higher the ADA for a program, the greater the amount of funds it will receive from the state.

2. School districts and charter schools calculate ADA and report it to CDE. After the charter schools report their ADA to CDE, the State Superintendent of Public Instruction apportions state school funds to the charter schools. The source of the ADA data reviewed by the audit team to determine the appropriateness of the charter school funding was from the charter schools' annual audited financial statements.

3. Senate Bill No. 740 (2001-2002 regular session Chapter 892) (S.B. 740) amended the Charter School Act. Pursuant to S.B. 740, the Legislature directed and authorized the SBE to establish criteria to evaluate funding requests from charter schools offering non-classroom-based instruction, and to determine the total amount of funding that each non-classroom-based charter school should receive.

4. Under S.B. 740, when applying for funding, independent study charter schools, such as those operated by OFY and OFL, must submit a Non-Classroom-Based S.B. 740 Funding Determination form (S.B. 740 form). Charter schools must report revenues and expenditures and may be eligible for either partial or full funding depending on the ratio of expenditures to revenues for selected items. SBE uses this data as a basis for making its determination of the percentage of funding that the school is eligible to receive in the upcoming year. For instance, the S.B. 740 form used to determine funding levels for 2005-2006 school year is based on actual financial data from the 2004-2005 school year.

5. S.B. 740 directed the SBE to adopt regulations setting forth criteria for funding of non-classroom based charter schools, and to appoint an advisory committee to recommend criteria for funding in accordance with Education Code section 47634.2. The Advisory Commission on Charter Schools (Advisory Commission or ACCS) was chosen by SBE to make recommendations on funding criteria.

6. In 2003, SBE adopted regulations which set forth requirements for determining funding levels for non-classroom-based charter schools. Pursuant to these regulations, 70 to 100 percent funding is available to a charter school if its ratios of certain expenses to revenues meet specific thresholds and its PTR meets stated minimum threshold requirements. PTR is calculated by dividing the total ADA by the total number of FTE teachers. OFY and OFL charter schools received 70 percent of available funding for the 2003-2004 school year.

7. Under the regulations, charter schools were ineligible for funding if they did not spend at least 35 percent of their total public revenues on compensation for certificated teachers or 60 percent of total public revenues on instruction and related services for the 2002/2003 fiscal year, and at least 40 percent of their total public revenues on certificated teachers or 60 percent of total public revenues on instruction and related services for the fiscal years covering 2003 through 2005.

8. The EAR and the Follow-Up Audit Report were prepared and issued by MGT in conjunction with the Fiscal Crisis and Management Assistance Team, which had been commissioned by the Superintendent of Public Instruction, in cooperation with the Los Angeles, Orange, Sacramento, San Bernardino and Siskiyou County Offices of Education, to conduct the audits.

9. Interveners contend that Appellants received excess funding from the state because they improperly calculated the number of FTE certificated teachers for inclusion in the PTRs, could not support the FTEs claimed, made errors in their PTR calculations, double-counted teachers, and included unallowable staff as FTE teachers.

Factual Findings Regarding PTR

10. Interveners called Gregory Geeting to testify regarding, inter alia, the funding for non-classroom based charter schools, and the effect of PTR on funding determinations. Mr. Geeting is an elected member and President of the Sacramento County Board of Education and a Representing Trustee of Area Number One. Mr. Geeting previously worked for the CDE within the Charter School Division as a Consultant and as an Administrator. As a Consultant, Mr. Geeting was the principal staff person for the oversight of SBE approved charter schools. Mr. Geeting attended and took meeting notes for the ACCS up to the point in time that he joined the ACCS as a member designated by the State Superintendent of Public Instruction.

11. Mr. Geeting is retired from the SBE, where he worked for more than 25 years and held a number of positions. During his employment with the SBE, Mr. Geeting served as an Interim Deputy Executive Director, as an Assistant Executive Director, and as the Executive Director. He was the Executive Director of the SBE on four separate occasions, the last occasion being in 2001. Mr. Geeting was also appointed Interim Director of the Charter Schools Division of the CDE. From 2001 to 2003, Mr. Geeting was the Assistant Executive Director of the SBE, serving as one of the two principal staff members for the ACCS during its commencement and development phase pursuant to S.B. 740. In addition to providing principal staff support, Mr. Geeting was directly responsible for the development and eventual submission of proposed regulations of S.B. 740 to the Office of Administrative Law. Finally, Mr. Geeting was personally involved when the PTR language was developed by the ACCS.

12. Mr. Geeting testified that prior to S.B. 740, the funding for charter schools was determined by the simple multiplication of two factors: the average daily attendance and the amount of funding based on the average daily attendance. The product of these two factors was the amount funding per average daily attendance owed to the charter school by the State. There was also a provision in the law that limited average daily attendance related to independent study and also limited PTR.

13. When S.B. 740 was enacted, it added a third factor, which was an adjustment by a percentage based on criteria created by the ACCS. In the process of developing the criteria, ACCS found two very significant factors in implementing S.B. 740: expenditures as a percentage of revenue that were made for certificated teachers and a broader criterion related to instructional costs. These two criteria were approved by the SBE and the Office of Administrative Law. According to Mr. Geeting, the SBE has the authority to set different adjustment percentages based on these criteria, anywhere from zero to 100 percent. If a charter school falls below a certain threshold for these criteria, it is possible that the non-classroom-based charter school may receive no funding. These threshold numbers were implemented because the ACCS, in its recommendations to the SBE, determined that if a school fell below this minimum threshold percent, it was deemed not substantially dedicated to the educational benefit of the students and therefore not worthy of state funding. Mr. Geeting noted that the SBE approved these criteria standards, which included a provision stating that it would apply the standards, "unless there's a reasonable basis to recommend something different."

14. Mr. Geeting disagreed with the notion that PTR is relevant only when a non-classroom-based charter school is seeking 100 percent funding under California Code of Regulations, title 5, section 11963.4, thereby exempting those charter schools with less than 100 percent funding from having to comply with PTR requirements altogether. According to Mr. Geeting, this interpretation of Regulation 11963.4 would allow a school to change the foundational element of its average daily attendance in order to receive lower than 100 percent funding levels. Further, schools would want less than 100 percent funding so that they could operate at any PTR without limitation. Mr. Geeting emphasized that this would lead to an absurd outcome that is counter to the structure and purpose of S.B. 740, which was to hold charter schools accountable for excessive profits and administrative expenditures. It would also significantly undermine and be inconsistent with public policy that holds non-classroom-based charter schools accountable to taxpayers.

15. Mr. Geeting stated that California Code of Regulations, title 5, section 11963.4, provides that PTR is one of the three essential criteria for determining funding for non-classroom based charter schools at 100 percent funding levels. The PTR was not mentioned at lower percentage funding levels because, from the standpoint of instructional quality, it was necessary to set a minimum PTR in order to receive full funding. Everything else is a reduction from full funding.

16. Although the PTR requirement was not expressly mentioned in Regulation 11963.4 for the lower funding levels, this section was never intended to nullify Education Code section 51745.6. According to Mr. Geeting, the regulations anticipated the application of section 51746.6 as it applies to the ADA claimed by charter schools receiving state funding.

17. Mr. Geeting further testified that regardless of the funding determination rate approved for the school, the PTR limitation on claimable ADA in Education Code section 51745.6 would still apply. The S.B. 740 implementing regulations were constructed on the presumption the PTR limitations of Education Code section 51745.6 would apply.

18. While working for SBE, Mr. Geeting was the liaison to the ACCS. Mr. Geeting was directly responsible for the interpretation and implementation of S.B. 740. He was also responsible for setting up the ACCS, drafting and revising regulations regarding funding determinations required by S.B. 740, and applying the regulations and SBE policies that governed funding determinations made by SBE. In addition to his testimony, Interveners submitted a declaration by Mr. Geeting, which was admitted into evidence. He stated in his declaration in pertinent part:

[A]t no time during the rulemaking process in which I was a participant or during the application of the regulations to charter school funding determination requests did the CDE, the ACCS, or the SBE ever interpret the funding determination regulations as eliminating, replacing, superseding or supplanting the PTR limitation on claimable ADA that is established pursuant to Education Code section 51745.6. Since the adoption of the S.B. 740 regulations related to funding determinations, it has been my understanding, and that of the CDE and SBE, that, in interpreting and applying S.B. 740, non-classroom-based charter schools were, have been, and continue to be subject to both the PTR limits on claimable ADA and the requirements of the funding determination statutes and regulations.

[¶] ... [¶]

There is nothing in S.B. 740, in the deliberations of the ACCS or the SBE or the regulations, or in the rulemaking file for the implementing regulations as filed with the Office of Administrative Law that would indicate any actual or intended interference with PTR limits on claimable ADA pursuant to Education Code section 51745.6.

The clear objective of the regulations is to encourage non-classroom based charter schools to devote more, not less, revenue to certificated salaries and other instruction-related costs in order to promote more effective instruction through independent study. The primary reason any charter school would receive a funding determination at less than the 100 percent rate would be the school's failure to devote sufficient revenues to certificated salaries and other instruction-related costs. If a charter school receiving less than a 100 percent rate is simultaneously released from the limitation on claimable ADA pursuant to Education Code section 51745.6, then the school with a higher PTR, is actually enabled to give individual students less attention by their teachers and thereby devote still fewer revenues to certificated salaries and instruction-related costs. That is the exact opposite of the intended effect of S.B. 740 and its regulations.

[¶] . . . [¶]

Exempting OFL and OFY (and any other charter school that might be inclined to accept a lower funding determination rate in exchange for no limitation of PTR) from limits on ADA pursuant to Education Code section 51745.6 would produce a dramatic and unintended financial windfall as compared to other charter schools and to public school districts that must comply with the PTR limits.

[¶] . . . [¶]

If Education Code section 51745.6 is not applied uniformly to non-classroom-based charter schools, but is only applied to schools receiving full-funding, a perverse fiscal incentive is established for schools not to request full funding and then have the ability to raise PTR with impunity.

19. Mr. Geeting estimated that, based on his review of the audit findings in Chapter 4 of the EAR related to OFY's and OFL's use of an unlawful FTE of 1.92 rather than the appropriate FTE of 1.0, OFY/OFL charter schools could be over-funded by as much as \$20 million per year. Mr. Geeting opined that the cumulative overpayment to OFY/OFL, as a result of using an erroneous FTE calculation, could exceed \$100 million by the time this case is resolved. Finally, Mr. Geeting stated that "Allowing non-classroom-based charter schools to retain excess revenue of that magnitude . . . was never contemplated during the deliberations of the CDE, ACCS, or SBE over the funding determination regulations."

20. Mr. Geeting was a key participant of the entire regulatory and deliberative process that established the regulations governing the funding of non-classroom based charter schools. As such, his testimony is given substantial weight.

The MGT Audit Team

21. Tyler Covey, the lead auditor of the MGT audit team, testified on behalf of Interveners. He is an audit expert and experienced in conducting investigative financial audits of charter schools including non-classroom based independent study charter schools. Mr. Covey is a certified public accountant, a certified management accountant, and a certified financial manager. He is employed as the Vice President of Education for a national public consulting firm. Previously, Mr. Covey worked for eight years for the California State Auditor. While there, he conducted performance and investigative audits.

22. Mr. Covey has also been employed as the Chief Financial Officer and Chief Operating Officer for a staffing company and Assistant Vice President for Bank of America. In addition, Mr. Covey was the Director of Performance Audits and Investigations for MGT. While employed at MGT, Mr. Covey conducted several investigative audits of non-classroom based independent charter schools under Education Code section 1241.5. Mr. Covey testified as both the lead auditor and as an expert regarding the findings of the EAR and the Follow-Up Audit Report.³

23. The audit led by Mr. Covey made specific findings of overfunding to OFL and OFY in the EAR. Specifically, Chapter 3 of the EAR sets forth findings based on an analysis of the financial data in the S.B. 740 forms that Appellants submitted to the state. Chapter 4 discussed the PTR findings, calculations of the ADA, and FTE teachers.

24. Mr. Covey's testimony was clear and concise. Based on his testimony and his personal knowledge and experience in performing audits of non-classroom based charter schools, Mr. Covey's testimony is given substantial weight.

Chapter 3 of the EAR

25. Chapter 3 of the EAR found that OFL-Baldwin Park and OFL-Capistrano charter schools were overpaid by an aggregate amount of \$6,727,317 resulting from inaccurate and/or unsupportable data on OFL's S.B. 740 Funding Determination forms, due to misclassification of various expenses such as administrators' salaries, automobile expenses, and professional development costs. When such improper expenses were properly adjusted, it caused OFL's ratio (reported as a percentage) of certificated staff compensation to total public revenues to fall below the minimum legal standard for funding eligibility for fiscal year 2004-

³ In addition to Mr. Covey, Dr. Keith Edmonds, Consultant for the Charter Schools Division, SBE, testified regarding the agency's interpretations of the legal requirements for classification of expenses on S.B. 740 forms.

05. Because OFL- Baldwin Park received over \$6.3 million in funding and OFL-Capistrano had received over \$400,000 in funding for that year, the EAR recommended that CDE determine whether funding should be disallowed and reimbursement made to the State.

26. The evidence established that the OFL charter schools at Baldwin Park and San Juan Capistrano incorrectly reported certain expense items in the certificated salary category rather than the "other instructional expenses" category as required by the S.B. 740 funding determination form. These errors are summarized on pages 76 and 77 of the EAR and include expenses such as automobile expenses and reimbursements and expenses for professional development. These schools also misclassified their administrator salaries and double counted some of these administrator salaries by improperly including them under certificated staff salaries. As a result, OFL inflated its S.B. 740 certificated staff percentages.

27. The improper categorization of expenses for OFL-Baldwin Park and OFL-San Juan Capistrano caused OFL to overstate their certificated staff salary percentages for these schools by 5.61 and 2.09 percent respectively. Neither school would have been eligible for funding had they correctly categorized the above expenses on their S.B. 740 forms because they would not have met the 40 percent requirement for certificated staff salaries (39.05 percent for Baldwin Park and 37.15 percent for San Juan Capistrano). Mr. Covey noted that while Appellants included automobile expenses and professional development costs as part of credentialed teacher salaries, they did not include these expenses as part of the classified or non-credentialed staff salaries. This shows that Appellants were, at the very least, inconsistent in categorizing their expenses.

28. As set forth in Chapter 3 of the EAR, Appellants OFY and OFL, in their S.B. 740 submissions, incorrectly reported certain expenses by coding them to wrong accounting categories. These errors are set forth in pages 67, 68 and 76 of the EAR. Appellants improperly included professional development expenses as part of teachers' salaries, improperly reported non-credentialed teacher and administrative bonuses as credentialed teacher bonuses, improperly categorized reimbursements as employee benefits, including reimbursements to teachers for purchasing school supplies, and reimbursements for automobile expenses. These expenses should have been classified under the category "All other instructional and related expenses."

29. During the audit for the 2004/2005 school year, Mr. Covey determined that the S.B. 740 funding form's classification of expenses was consistent with the requirements of the California School Accounting Manual and CDE instructions. In general, employee benefits that are considered part of employee salaries include health insurance, dental insurance, and Social Security payments. Reimbursements for automobile expenses should not be classified as employee benefits on the S. B. 740 funding determination form.

30. Patricia Loncaric, Appellants' controller, testified that she relied on an Internal Revenue Service (IRS) publication, which she claimed provided for tax benefits to teachers for out of pocket expenses, such as travel expenses. She also included gift certificates as part

of “benefits and salaries of certificated staff because she considered them “bonuses.” Her testimony is not persuasive. The IRS publications (Appellants’ Exhibits 38, 39 and 40) do not specifically state that these expenses are considered benefits to be included as salary. Further, the IRS publications pertain to unreimbursed expenses, not the reimbursed expenses that were misclassified by Appellants in their S.B. 740 funding determination forms.

31. Appellants contend that because of the confusing instructions on the “2004-05 Instructions for SB 740 Funding Determination Form” (Exhibit 194), they reasonably concluded that travel, professional development, and conference expenses were properly included in the certificated teacher salary category. Appellants’ contention is rejected. Section 1.a. of the SB 740 Instructions states, “Salaries and Benefits include those for teachers, aides, specialists, and other personnel who are employees of the charter school and provide direct instruction or related support services to students. . . . Personnel costs associated with school-sponsored extra-curricular or co-curricular activities designed to provide motivation and enjoyment and improvement of skills or personal development in either a competitive or non-competitive setting (e.g. athletics, music/band/choir, debate, public speaking, and student services to the community) are also included.” It is clear that the “personnel costs” referenced in section 1.a., refer to expenses for programs and activities that are for the personal development of the students. This section does not include expenses related to the professional development of teachers. Nor does it refer to travel expenses for teacher conferences. In fact, the S.B. 740 Instructions has a separate category for teacher professional development and related expenses. Section 1.c.iii states in pertinent part “All other instruction and related services and other operating costs include travel, conference and professional development costs for instructional or related personnel . . .”

32. Interveners contend that the misclassification of expenses as described in the above findings of fact were deliberate actions on the part of Appellants. As such, they were not inadvertent mistakes in classification of expenses. The S.B. 740 Instructions are not confusing. They clearly distinguish between “Certificated employee salaries and benefits” and “All other instruction and related services and operating costs.” Therefore, Appellants’ misclassification of expenses was intentional. Further, the double counting of salaries of administrators by also including them in the certificated teacher category, even though they were not actually teaching classes, was also an intentional misclassification.

Chapter 4 of the EAR

33. The EAR sets forth that Appellants OFY and OFL used unlawful practices and methods to calculate the number of FTE certificated teachers for inclusion in the PTRs to determine the amount of state funding received based on ADA. More specifically, Chapter 4 of the EAR states that as a result of OFL's and OFY's improper use of an FTE of 1.92, rather than the appropriate FTE of 1.0, Appellants OFY and OFL were overpaid an aggregate of \$20,306,813 for OFY for all three fiscal years, and \$13,969,601 for OFL for all three fiscal years.

34. For the purpose of calculating PTR for apportionment, OFY and OFL utilized a formula whereby a full-time teaching assignment at their schools resulted in a 1.92 FTE. In essence, appellants arrived at FTE by dividing annual instruction time specified in their teacher contracts (1,680 hours) by the annual instruction time of teachers in the school district where they are located (875 hours). OFY and OFL contended that the teachers of their charter schools work more days and hours than a “typical” teacher due to their year-round calendar and longer school day. They also asserted that numerous other schools throughout California claim teachers at a rate of greater than 1.0 FTE. To determine whether the 1.92 methodology is permissible under existing laws and regulations, the audit team sought a legal opinion from CDE’s attorneys. The CDE’s attorney opined that the 1.92 methodology does not comply with existing laws and regulations and that the charters should claim their teachers on a 1.0 FTE scale. OFY and OFL disputed this legal opinion. The ALJ has previously ruled that Appellants were wrong in assigning a 1.92 FTE for each teacher. The basis for this ruling is set forth in the legal conclusions below.

35. With respect to other EAR Chapter 4 findings, the evidence established that Appellants misclassified and improperly reported certain employees and administrators as FTE certificated teachers, miscalculated and erred in rounding out PTRs, and misreported Appellants’ PTRs and the PTRs of the comparison largest unified school districts. Appellants also made rounding errors in their calculations of the PTR for certain of their charter schools. In addition, Appellants incorrectly reported the PTRs of the largest unified school districts in the counties in which the charter schools operate. After reviewing Appellants’ S.B. 740 submissions regarding the reported PTR of the largest school district in each relevant county, the audit team contacted these school districts to verify the actual PTR of each district. For example, as verified by the auditors, the PTR for LAUSD for the fiscal years 2001/02 and 2002/03 was 21 pupils for each teacher in the district.

36. Exhibit 17 contains documentation showing that the PTR for LAUSD for fiscal years 2001/02 and 2002/03 was 21-to-1, while the PTR for this district in 2003/04 and 2004/05 was 22-to-1. These PTRs are inconsistent with Appellants’ Exhibits 250 and 284, which were also admitted as administrative hearsay and set forth an LAUSD PTR of 41-to-1 (Appellants apparently obtained Exhibits 250 and 284 from an LAUSD website according to paragraph 37 of their proposed “Factual Findings and Legal Conclusions”). Interveners’ Exhibit 17 and Appellants’ Exhibit 250 and 284 are relevant to a major issue in this case. The ALJ, in order to make a complete administrative record, gave Appellants the opportunity to schedule another hearing day to cross-examine Mr. Covey on Exhibit 17 and to call as a witness, a representative from LAUSD to authenticate and to explain the information contained in Exhibits 250 and 284. Appellants declined both opportunities despite having the burden of proof in this case. Since no one from LAUSD was called to testify, the undersigned is left with two hearsay documents (Exhibits 250 and 284) taken from an internet website, which are insufficient by themselves to support a factual finding. Finally, the information regarding the LAUSD PTR set forth in Appellants’ S.B. 740 submissions are actually more consistent with the PTRs contained in Exhibit 17 than with the PTRs contained in Exhibits 250 and 284. (See EAR tables 4-8 and 4-10).

37. Regarding other issues raised in Chapter 4 of EAR, the evidence established that Appellants double counted some teachers and counted other staff, employees, or administrators in the certificated teacher category even though these other employees had no students and were not actually teaching classes. The results of these errors on the part of OFY are set forth on page 95 of EAR on table 4-7. As set forth in table 4-7 in the EAR, OFY claimed 43 unallowable FTE teachers during the three audited years starting in 2002/2003 school year. The majority of FTE errors were attributed to OFY-Mount Shasta during the 2002/2003 and 2003/2004 school years. These errors in the FTE calculations resulted in Mount Shasta incorrectly stating its PTR on the S.B. 740 Funding Determination Form. As a result, OFY-Mount Shasta was overpaid an aggregate amount of \$164,068 for the 2002/2003 and 2003/2004 school years.

38. As set forth in Table 4-9 of the EAR, Appellant OFL lacked support for 21 FTE teachers and another 25 FTEs were questionable. As an example, both OFL-Baldwin Park and OFL-William S. Hart claimed administrators as teachers even though these administrators provided no direct instruction to students. A certificated employee must provide direct instruction to students to properly claim that employee as an FTE teacher. When adjusting for disallowed FTE and comparing the auditor calculated PTR of OFL-Baldwin Park and OFL-William S. Hart with the auditor verified PTRs of the largest unified school district, which in this case was the LAUSD, the auditors found the two OFL schools were overpaid by more than \$3.6 million (\$3,636,737).

39. The PTRs reported by MGT in the EAR at Table 4-10, are accurate and correct as the actual PTRs of the largest unified school districts. The following factual findings set forth the correct PTRs for certain schools, the comparison PTRs of the largest school districts, and resulting overpayment to OFL charter schools.

40. The total recommended apportionment funding disallowances for OFL-Baldwin Park for the fiscal year 2002-03 based on its PTR exceeding that of the auditor verified PTR of the largest unified school district, is based on the difference between its PTR of 27 and LAUSD's PTR of 21. As a result OFL-Baldwin Park was overpaid \$1,183,641 for that fiscal year.

41. For fiscal year 2002-03, OFL-William S. Hart's actual PTR, after adjusting for disallowed FTE, was 23. That PTR exceeded the auditor verified PTR of 21 for the largest unified school district (LAUSD), which resulted in an overpayment of \$718,441.

42. For fiscal year 2003-04, OFL-Baldwin Park's actual PTR, after adjusting for disallowed FTE, was 29. That PTR exceeded the auditor verified PTR of 22 for the largest unified school district (LAUSD), which resulted in an overpayment to OFL-Baldwin Park of \$1,539,720.

43. For fiscal year 2004-05, OFL-William S. Hart's actual PTR, after adjusting for disallowed FTE, was 26. That PTR exceeded the auditor verified PTR of 25 for the largest unified school district, again LAUSD, which resulted in an overpayment of \$194,935.

44. The total overpayment to OFL-Baldwin Park and OFL-William S. Hart due to its pupil-to-teacher ratios in excess of the largest unified school district for the three audited years amount to an aggregate of \$3,636,737.

45. During the audit, no one from or on behalf of OFY or OFL informed Mr. Covey or the audit team that Appellants were not subject to the PTRs and did not have to make any repayment of overfunding because they were not at the 100 percent funding level.

The Follow-Up Audit

46. The Follow-Up Audit found similar errors in the calculation of OFL's PTR for fiscal year 2001-02 that resulted in an overpayment of funds to OFL. The evidence established that OFL-William S. Hart charter school was overpaid \$601,271 for fiscal year 2001/2002 due to its miscalculations and use of inaccurate PTR.

GENERAL LEGAL CONCLUSIONS

47. Pursuant to Education Code section 41344, subdivision (d), and Evidence Code section 500, Appellants have the burden of proof to establish by a preponderance of the evidence that the EAR and the Follow-Up Report contain findings that are based on errors of fact or interpretations of law.

48. The California Supreme Court has held that deference should be given to an agency's interpretation of a regulation where "the agency has expertise and technical knowledge, especially where the legal text to be interpreted is technical, obscure, complex, open-ended, or entwined with issues of fact, policy, and discretion. [Further], a court is more likely to defer to an agency's interpretation of its own regulation since the agency is likely to be intimately familiar with regulations it authored and sensitive to the practical implications of one interpretation over another." (*Yamaha Corporation of America v. State Board of Equalization* (1998) 19 Cal.4th 1, 12.) In addition, greater deference is appropriate where there are "indications of careful consideration by senior agency officials." (*Yamaha, supra*, 19 Cal.4th at p. 13.) The *Yamaha* court also held that an agency's interpretation warrants increased deference when there is "evidence that the agency 'has consistently maintained the interpretation in question, especially if [it] is long-standing' [citation] ... and [there are] indications that the agency's interpretation was contemporaneous with legislative enactment of the statute being interpreted. (*Yamaha, supra*, 19 Cal.4th at p. 13.)

LEGAL CONCLUSIONS RE: EAAP JURISDICTION OVER S.B. 740 FUNDING ISSUES

49. At the hearing in Phase I, Interveners requested the ALJ to dismiss the appeals by OFL and OFY regarding the S.B. 740 related findings of Chapter 3 of the Extraordinary Audit and to the S.B. 740 related findings of the Follow-Up Audit. Interveners cite the precedential decision *In the Matter of Gorman Learning Center*, Case No. 07-05 (Decided by EAAP on December 16, 2008) in support of their position. In *Gorman*, the EAAP did not specifically state that it lacked jurisdiction to hear appeals of audit findings relating to S.B. 740 funding determinations. The EAAP concluded that it had no authority to determine whether a charter school may be required to repay any amount as a result of audit findings related to the information submitted to SBE on the charter school's SB 740 funding determination request.

50. Education Code section 41344.1, subdivision (b), authorizes EAAP to hear appeals such as those filed by appellants in the instant case. Education Code sections 41344, subdivision (d), and 41344.1, subdivision (b), do not limit the jurisdiction of EAAP to resolve alleged violations of statutes and regulations that are conditions of apportionment. Rather, section 41344, subdivision (d), provides that the extent of the audit could include "all or any part of the operations of the local educational agency." It further provides for a hearing before EAAP "at which the local educational agency may present evidence or arguments if the local educational agency believes that the final report contains **any finding** that was based on errors of fact or interpretation of law . . ." (Emphasis added.) In addition, Education Code section 41344.1, subdivision (b), provides that the EAAP "panel shall consider audit appeals pursuant to the administrative adjudication provisions of the Administrative Procedure Act" and "may approve settlements and make findings of fact and interpretations of law."

51. The EAAP adopted regulations which set forth rules governing the audit and appeals process. California Code of Regulation, title 5, section 19815, delineates the requirements and the format of an audit report. Regulation section 19853, entitled Determination of Funding for Nonclassroom-Based Instruction, directs the auditor to "verify the accuracy of data submitted by the charter school to the Department of Education on the nonclassroom-based funding determination form applicable to the year being audited." If the auditor identifies any such inaccurate data, subdivision (d) of this regulation directs the auditor to "prepare a schedule displaying the inaccurate data" and to "include the schedule in the Findings and Recommendations section of the audit report."

52. The EAAP has set forth the requirements and components of an audit report in its regulations. The EAAP has also directed the auditor to verify the S.B. 740 data submitted by appellants, and to identify inaccuracies in the submitted data. Further, the EAAP has directed the auditor to include a schedule of these inaccuracies in the Findings and Recommendations of the audit report. Therefore, any inaccuracies identified by the auditor of the data submitted by Appellants to the Department of Education for S.B. 740 funding determinations are considered "Findings" under both Regulation section 19853, and

Education Code section 41344, subdivision (d). As a result, these “Findings” are appealable under Education Code section 41344, and unless previously litigated and decided in these proceedings, Appellants are allowed to present evidence and argument to support its contention that the alleged inaccuracies in their S.B. 740 submissions are based on errors of fact or interpretations of law. Further, after a hearing on the merits, the EAAP may make factual findings and legal conclusions regarding the accuracy of the S.B. 740 data submitted by Appellants even if EAAP does not have the authority to order repayment of any overfunded amounts.

53. Based on the above analysis, the EAAP has jurisdiction to hear S.B. 740 related findings of the Extraordinary Audit and the S.B. 740 related findings of the Follow-Up Audit.

LEGAL CONCLUSIONS RE: FULL-TIME EQUIVALENTS

54. Education Code section 51745.6, subdivision (a), requires that PTRs for non-classroom-based charter schools be equal to or less than those of the largest unified school districts in the counties in which the charter schools operate. Subdivision (e) of section 51745.6 provides that the PTR of a charter school may also be calculated by using a fixed PTR equal to or less than 25 to 1.

55. Appellants contend that since their teachers are required to work almost twice as many hours per year (1,680 hours per year pursuant to their employment contracts) as full time teachers in traditional public schools (875),⁴ they should be allowed to claim 1.92 FTE for each full-time teacher. At the hearing in Phase I, appellants asserted that the definition of an FTE in California Code of Regulations, title 5, section 11700 supports their position that they are entitled to claim 1.92 FTEs for each full time teacher at their charter schools. Appellants’ position is not persuasive. Regulation 11700 sets forth employee assignments (full-time and part-time) that would aggregate to the amount of instructional time specified in the contract of a full-time certificated classroom teacher of the district or County Office of Education.⁵ Regulation 11700 does not state that an FTE can be greater than one.

⁴ It is unclear how appellants arrive at this number other than asserting that teachers in traditional public schools work five instructional hours a day for 175 days during the school year. California Code of Regulations, title 5, section 11704, defines a “full-time certificated employee” as “an employee who is required to work a minimum six-hour day and 175 days per fiscal year. Part-time positions shall generate a partial FTE on a proportional basis.”

⁵ Regulation 11700, subdivision (a), states, “Full-time equivalent certificated employees’ means any combination of full-time certificated employees and part-time certificated employee assignments that aggregate to the amount of instructional time specified in the contract of a full-time certificated classroom teacher in the district or county office of education.”

56. California Code of Regulations, title 5, section 11704 defines a “full-time certificated employee” as “an employee who is required to work a **minimum** six-hour day and 175 days per fiscal year.” (Emphasis added.) Full-time status is defined by a floor and not a ceiling. There is nothing in this regulation that allows a charter school to claim an FTE greater than one for a full-time teacher who, pursuant to his/her contract, is required to work more than the specified minimum daily and yearly hours.

57. Requiring certificated teachers to work more than the mandatory minimum hours set forth in statutes and regulations is not prohibited. Education Code section 45024 is illustrative. Although this section does not directly govern independent study charter schools, it allows a governing board to require “full-time certificated employees to serve a longer period of time than the minimums defined in Education Code sections 46112 to 46116.” The fact that certain non-classroom-based charter schools require their teachers to work more days or hours per year, does not allow them expand the definition of FTE.

58. Appellants also asserted that they should be allowed to claim 1.92 FTE for each full-time teacher because they relied on certain publications from the California State Teachers Retirements System and CDE to support their claim. Appellants further assert that this reliance created a good faith belief that they were in “substantial compliance” with all legal requirements pursuant to Education Code section 41344, subdivision (d). Appellant’s assertion is not persuasive. Education Code section 41344.1, subdivision (c), defines substantial compliance as “nearly complete satisfaction of all material requirements of a funding program that provide an educational benefit substantially consistent with the program’s purpose. A **minor or inadvertent** noncompliance may be grounds for a finding of substantial compliance provided that the local educational agency . . . acted in good faith to comply with the conditions established by law or regulations necessary for apportionment funding.” (Emphasis added.) Appellants have not met the standard for substantial compliance in this case. The difference between the claimed 1.92 FTE and allowable 1.0 FTE is not a “minor” noncompliance under Education Code section 41344.1.

59. Appellants OFY and OFL did not present sufficient legal authority to support their contention that they should be allowed to claim 1.92 FTE for their employees who are full-time certificated teachers. Indeed, Appellants did not establish that they are entitled to claim more than one FTE for each full-time certificated teacher who teaches at their independent study charter schools.

LEGAL CONCLUSIONS RE: PTR

60. S.B. 740 amended Education Code sections 47605 and 47612.5, and added sections 47614.5, 47616.7 and 47634.2. Among other things, these statutes addressed funding requirements for independent study, non-classroom based charter schools.

61. Prior to the enactment of S.B. 740, Education Code section 47612.5, subdivision (b), stated in pertinent part: “(b) Notwithstanding any other provision of law, a charter school that provides independent study shall comply with Article 5.5 (commencing with section 51745) of Chapter 5 of Part 28 and implementing regulations adopted thereunder.”

62. The original language of Education Code section 47612.5 required independent study charter schools to comply with the PTRs set forth in Education Code section 51745.6, subdivision (a), which requires PTRs for district independent study programs to be equal to or less than the PTR for all other educational programs operated by the district. In addition, subdivision (a) requires PTRs for county independent study programs to be equal to or less than the PTRs of all other educational programs operated by the largest high school or unified school district in that county. Subdivision (e) gives a charter school the option to apply a fixed PTR of 25 pupils per certificated employee (25:1).

63. Under Education Code section 51745.6, subdivision (b), schools with independent study programs are not prohibited from serving additional units of ADA, but only those units of ADA that comply with the PTR set forth in subdivision (a), are eligible for apportionment. The additional units of ADA are not funded.

64. With the passage of SB 740, Education Code section 47612.5 was amended and states in pertinent part:

(b) Notwithstanding any other provision of law, **and except to the extent inconsistent with this Section and Section 47634.2**, a charter school that provides independent study shall comply with Article 5.5. (Commencing with Section 51745) of Chapter 5 of Part 28 **and the implementing regulations adopted thereunder**. (Emphasis added.)

[¶] . . . [¶]

(d)(1) Notwithstanding any other provision of law . . . a charter school that has an approved charter may receive funding for nonclassroom-based instruction **only** if a determination is made pursuant to Section 47634.2 by the State Board of Education. The determination for funding shall be subject to any conditions or limitations the State Board of Education may prescribe. The State Board of Education shall adopt regulations on or before February 1, 2002, that define and establish general rules governing nonclassroom-based instruction that apply to all charter schools **and to the process for determining funding for nonclassroom-based charter schools** offering nonclassroom-based instruction . . . (Emphasis added.)

65. The newly adopted Education Code section 47634.2 mandated that criteria for funding adjustments for independent study charter schools include, among other things, the schools' PTRs. Section 47634.2 also directed the SBE to adopt regulations setting forth criteria for funding of non-classroom-based instruction at charter schools. It further directed SBE to appoint an advisory committee to recommend criteria for funding in accordance with Education Code section 47634.2. The ACCS was chosen by SBE to make recommendations on funding criteria. Section 47634.2 states in pertinent part:

(a)(1) Notwithstanding any other provision of law, the amount of **funding to be allocated to a charter school on the basis of average daily attendance that is generated by pupils engaged in nonclassroom based instruction**, as defined by paragraph (2) of subdivision (d) of Section 47612.5, including funding provided on the basis of average daily attendance pursuant to Sections 47613.1, 47633, 47634, and 47664, **shall be adjusted by the State Board of Education**. The State Board of Education shall adopt regulations setting forth criteria for the determination of funding for nonclassroom based instruction. . . . In developing these criteria and determining the amount of funding to be allocated to a charter school pursuant to this section, the State Board of Education **shall consider**, among other factors it deems appropriate, the amount of the total budget expended on certificated employee salaries and benefits and on school sites, as defined in paragraph (3) of subdivision (d) of Section 47612.5, **and the teacher-to-pupil ratio in the school.** (Emphasis added.)

[¶] . . . [¶]

(b)(3) The determination for funding shall be on a percentage basis and the superintendent shall implement the determination for funding by reducing the charter school's reported average daily attendance by the determination for funding percentage specified by the State Board of Education.

(b)(4) If the State Board of Education denies a request for a determination for funding or provides for a reduction as authorized by subdivision (a), the board shall, in writing, give the reasons for its denial or reduction, and if appropriate, may describe how any deficiencies or problems may be addressed.

66. The language of Education Code section 47634.2, subdivision (a)(1), provides SBE with discretion to "adjust" the amount of funding for non-classroom-based charter schools. But the basis for funding allocations for such schools continues to be the

computation of ADA. Further, the Legislature directed the SBE to adopt regulations that set forth criteria for funding that included, at minimum, certain expenditures **and** the PTR of the school. In enacting Education Code section 47634.2, the Legislature intended to provide for additional funding criteria for independent study charter schools that would lead to greater accountability, not to supplant the ADA and PTR basis for funding. Therefore, Education Code section 51745.6 continues to apply to non-classroom-based charter schools.

67. The legislative history of S.B. 740 supports the above interpretation of Education Code sections 47612.5 and 47634.2. The “Summary” of the Senate deliberative process states in section 7:

Requires the amount of funding to be allocated to a charter school on the basis of ADA that is generated by pupils engaged in non-classroom-based instruction and states that it will be adjusted by SBE.

(a) Requires SBE to adopt regulations setting forth criteria for the determination of funding for non-classroom-based instruction and at a minimum the regulation must specify that the instruction is conducted for the instructional benefit of the student. In developing these criteria and determining the amount of funding to be allocated to a charter school pursuant to this legislation, SBE **must consider**, among other factors it deems appropriate, the amount of total budget expended on certificated employee salaries and benefits and on school sites, and **the teacher-to-pupil ratio in the school**. (Emphasis added.) (Senate Third Reading, Amended September 12, 2001.)

68. In using the words “must consider . . . the teacher-to-pupil ratio” in its Summary, the legislature made its intention clear. Further, the legislature did not indicate an intention to provide for exceptions or to eliminate the PTR requirements for funding levels at less than 100 percent.

69. Although not generally recognized as a factor in determining legislative intent, the signing statement of then Governor Gray Davis provides context and gives more insight into the reason for the passage of S.B. 740. This statement provides in pertinent part:

I am signing Senate Bill 740 which would authorize the State Board of Education to appropriately adjust funding per student for non-classroom-based charter schools. . . . [T]he current charter school funding provisions in current law provide more funding than necessary for non-classroom based instructional methods. This bill would allow the State Board of Education to assign funding rates for non-classroom-based charter school programs that are more

consistent with cost-based characteristics of the instructional program employed. Furthermore, this bill would lead to greater accountability and better instructional services by encouraging classroom-based instruction among charter schools. (Historical and Statutory Notes, Education Code section 47605)

70. In 2003, the SBE, in accordance with S.B.740, adopted the funding regulations for non-classroom-based charter schools which are set forth in regulation section 11963, et seq. The version of Regulation section 11963.4, in effect during the relevant time period, set forth specific funding requirements, and stated in pertinent part:

When a complete determination of funding request is received from a charter school, it shall be reviewed by the California Department of Education and presented to the Advisory Commission on Charter Schools, along with credible information pertaining to the request obtained from any other source. The Advisory Commission shall develop a recommendation pursuant to this section to the State Board of Education regarding the request, and that recommendation shall be presented to the State Board of Education by the California Department of Education. The following criteria shall guide the process of reviewing and developing a recommendation on the request. The California Department of Education shall report any difference of opinion between the California Department of Education and the Advisory Commission as to the recommendation presented to the State Board of Education.

[¶] . . . [¶]

(b) For the 2003-04 fiscal year and each fiscal year thereafter:

(1) If the percentage calculated pursuant to paragraph (1) of subdivision (c) of Section 11963.3 equals at least 40 percent but less than 50 percent, and the percentage calculated pursuant to paragraph (2) of subdivision (c) of Section 11963.3 equals at least 60 percent but less than 70 percent, the Advisory Commission on Charter Schools shall recommend to the State Board of Education approval of the request at 70 percent, unless there is a reasonable basis to recommend otherwise. If the recommended percentage is lower than the requested percentage, the recommendation to the State Board shall include the reasons justifying the reduction and, if appropriate, describe how any deficiencies or problems may be addressed by the charter school.

(2) If the percentage calculated pursuant to paragraph (1) of subdivision (c) of Section 11963.3 equals or exceeds 50 percent, and the percentage calculated pursuant to paragraph (2) of subdivision (c) of Section 11963.3 equals at least 70 percent but less than 80 percent, the Advisory Commission on Charter Schools shall recommend to the State Board of Education approval of the request at 85 percent, unless there is a reasonable basis to recommend otherwise. The recommendation to the State Board shall include the reasons justifying a percentage that is greater than 70 percent and, if the recommended percentage is lower than the requested percentage, the reasons justifying the reduction and, if appropriate, describe how any deficiencies or problems may be addressed by the charter school.

(3) If the percentage calculated pursuant to paragraph (1) of subdivision (c) of Section 11963.3 equals or exceeds 50 percent, the percentage calculated pursuant to paragraph (2) of subdivision (c) of Section 11963.3 equals or exceeds 80 percent, and the charter school's pupil-teacher ratio is equal to or less than the pupil-teacher ratio of the largest unified school district in the county or counties in which the charter school operates as reported pursuant to paragraph (2) of subdivision (b) of Section 11963.3, the Advisory Commission on Charter Schools shall recommend to the State Board of Education approval of the request at 100 percent (i.e. full funding), unless there is a reasonable basis to recommend otherwise. The recommendation to the State Board shall include the reasons justifying a percentage that is greater than 70 percent and, if the recommended percentage is lower than the requested percentage, the reasons justifying the reduction and, if appropriate, describe how any deficiencies or problems may be addressed by the charter school.

(4) If the percentage calculated pursuant to paragraph (1) of subdivision (c) of Section 11963.3 is less than 40 percent, or the percentage calculated pursuant to paragraph (2) of subdivision (c) of Section 11963.3 is less than 60 percent, then the charter school's nonclassroom-based instruction is not substantially dedicated to the instructional benefit of the students, and the Advisory Commission on Charter Schools shall recommend that the State Board of Education deny the request, unless there is a reasonable basis to recommend otherwise. The recommendation to the State Board shall include the reasons justifying the denial and, if appropriate, describe how any deficiencies or problems may be addressed by the charter school. Denial of a determination of

funding request by the State Board of Education shall result in no funding being apportioned for average daily attendance identified by the charter school as being generated through nonclassroom-based instruction pursuant to Education Code section 47634.2(c).⁶

71. The reference to “percentage calculated” in Regulation 11963.4 is to the ratio of credentialed teacher salaries and total expenditures for instruction, to public revenue received by the charter school. (See California Code of Regulations, title 5, section 11963.3.) Under Regulation 11963.4, subdivision (b)(4), if the percentage of salaries for certificated staff who provide direct instruction or instructional support to students, to total public revenues, fell below 40 percent, the ACCS is required to recommend denial of funding unless there is a reasonable basis to recommend otherwise.

72. Although PTR is not mentioned in Regulation 11963.4, for funding levels at less than 100 percent, the PTR requirements set forth in Education Code section 51745.6 continued to apply to non-classroom-based charter schools after passage of S.B. 740 and the subsequent adoption of funding regulations by SBE. The relevant statutes and the strong language contained in the legislative history, show that the legislature intended that ADA and PTR requirements should be applied at all funding levels.

73. Regulatory support for the position that Education Code section 51745.6 continues to be applicable to non-classroom based charter schools is found in California Code of Regulations, title 5, section 11704, which provides for a maximum PTR of 25:1 for independent study programs in charter schools; or a maximum PTR that “does not exceed the PTR for all other educational programs operated by the largest unified school district, as measured by the average daily attendance, in the county or counties in which the charter school operates. Units of independent study that are ineligible for apportionment as provided in subdivision (b) of Education Code section 51745.6, shall also be ineligible for funding pursuant to Chapter 6 (commencing with section 47630) of Part 26.8 of the Education Code.”

74. Additional support for the above analysis is found in Regulation 11963.1, which states: “This article does not change the requirement that nonclassroom-based instruction in charter schools comply with the provisions of Article 5.5 (commencing with section 51745) of Chapter 5 of Part 28 of the Education Code.” The language of section 11963.1 supports Interveners’ contention that the adoption of regulation 11963.4 was never intended to supplant or supersede the PTR requirements set forth in Education Code section 51745.6.

75. Once the Advisory Commission arrives at a recommended funding level, it presents this recommendation to the California Department of Education (CDE) which in turn reviews the recommendation and presents it to the SBE, along with any difference of

⁶ Regulation 11963.4 was amended effective December 6, 2005, changing various percentages in the funding formula. However, these changes became operative after the relevant time period of the audit.

opinion it might have with the recommended funding. Even if a charter school meets the percentage and PTR requirements set forth in Regulation 11963.4, the Advisory Commission still has the discretion to recommend reduced funding if there is a reasonable basis to do so.

LEGAL CONCLUSIONS RE: OVERFUNDING

76. Appellants OFY and OFL failed to establish that the Findings and Determinations set forth in the EAR and the Follow-Up Audit Report were based on factual errors or misinterpretations of law.

77. Appellants failed to establish that they substantially complied with the relevant statutes and regulations governing S.B. 740 funding determinations.

Legal Conclusions Re: Overfunding Determinations in Chapter 4 of EAR

78. In this case, Appellants submitted S.B. 740 requests for funding. In connection with these requests, Appellants supplied information on average daily attendance along with an assigned 1.92 FTE for each certificated full-time teacher. Thereafter, SBE authorized the funding at 70 percent.

79. The funding limitations and the PTR requirements set forth in Education Code section 51745.6 continue to apply to non-classroom-based charter schools after passage of S.B. 740 and the subsequent adoption of funding regulations by SBE. Appellants' contention that PTRs are not applicable to funding determinations at less than 100 percent under Regulation 11963.4 is rejected. Appellants' interpretation of Regulation 11963.4 would allow a non-classroom based charter school to have an unlimited PTR and still receive 70 or 85 percent funding under Regulation 11963.4, subdivisions (a)(1) and (a)(2). Allowing non-classroom based charter schools to operate with an unlimited PTR would reduce the students' opportunity to learn because they would receive less individual attention. It would also provide a financial windfall for non-classroom based charter schools that choose not to comply with PTR requirements. Such a result would be against the stated public policy requiring greater accountability of non-classroom based charter schools and is in conflict with the enabling statutes.

80. Appellants have been overfunded pursuant to Education Code sections 47612.5, 47634.2 and 51745.6 as a result of the inappropriate 1.92 FTE assignments for each certificated teacher who taught at their non-classroom-based charter schools. The overfunding is \$20,306,813 for OFY and \$13,969,601 for OFL. This conclusion is based on Factual Findings 10 through 20, 33 and 34, and Legal Conclusions 54 through 74.

81. Appellant OFY was overfunded by \$164,068 for the fiscal years of 2002-03 and 2003-04 due errors in unallowable FTE certificated teachers, inaccurate PTRs and errors in rounding the PTR, as set forth in Factual Findings 37.

82. Appellant OFL was overfunded by an aggregate of \$3,636,737, due to errors in use of unallowable FTEs of certificated teachers, inaccurate PTRs and errors in rounding the PTRs of its schools as noted in Chapter 4, as set forth in Factual Findings 38 through 45

Legal Conclusions Re: Overfunding Determinations in Chapter 3 of EAR

83. Appellant OFL-Baldwin Park and OFL-San Juan Capistrano misclassified certain expenses as set forth in Factual Findings 25 through 28. After an adjustment of these misclassified expenses in EAR, these schools failed to meet the threshold minimum of 40 percent ratio of certificated staff compensation to total public revenues for the 2004/2005 school year. As a result, OFL was ineligible for the 70 percent funding determination it received for OFL-Baldwin Park in the amount of \$6,317,319, and \$409,998 funding determination that it received for OFL-San Juan Capistrano.

Legal Conclusions Re: Overfunding Determinations in the Follow-up Audit Report

84. Appellant OFL was overfunded by \$601,271, due to inaccurate use and reporting of PTRs for its William S. Hart School for the fiscal year 2001-02, as set forth in Factual Finding 46.

ORDER

MGT of America, Inc. is hereby ordered to prepare a schedule setting forth the inaccurate and misclassified expenses and the corresponding correct data and include such schedule of data in the Findings and Recommendations section of Chapter 3 of the EAR pursuant to *Gorman Learning Center (Part I)*, and consistent with the Factual Findings and Legal Conclusions herein. The education audit appeals of OFY and OFL are denied in all other respects and the audit findings are affirmed.

DATED: February 21, 2014

Original Signed
HUMBERTO FLORES
Administrative Law Judge
Office of Administrative Hearings

**BEFORE THE
EDUCATION AUDIT APPEALS PANEL
STATE OF CALIFORNIA**

In the Matter of the Consolidated Audit
Appeals of:

OPTIONS FOR YOUTH, et al., and
OPPORTUNITIES FOR LEARNING, et al.,

Appellants,

v.

STATE CONTROLLER'S OFFICE

Respondent,

and

CALIFORNIA DEPARTMENT OF
FINANCE, CALIFORNIA DEPARTMENT
OF EDUCATION and STATE BOARD OF
EDUCATION,

Interveners.

EAAP Case Nos. 06-18

06-19

07-07

07-08

OAH Nos. L2006110025

L2006100966

L2007060722

L2007060728

**FACTUAL FINDINGS AND LEGAL CONCLUSIONS FOR PHASE I
AFTER RECONSIDERATION**

This matter, before the Education Audit Appeals Panel (EAAP), was heard by Humberto Flores, Administrative Law Judge with the Office of Administrative Hearings. Pursuant to a stipulation by appellants and interveners, the hearing in this matter has been bifurcated into two phases. Phase I of this matter was held in Los Angeles, California, on February 20, 21 and 22, 2008.

Deputy Attorneys General Ernest Martinez and Phillip Matsumoto represent interveners California Department of Finance (DOF), California Department of Education (CDE), and the State Board of Education (SBE).

Gregory M. Bordo and Armen G. Mitilian of Freeman, Freeman & Smiley, LLP, represent appellants Opportunities for Learning (OFL) and Options for Youth (OFY).

Respondent State Controller did not appear at the hearing. In a letter dated November 21, 2007, Shawn Silva, Staff Counsel for the State Controller's Office, explained that the State Controller's Office would make no further appearances in this matter.

INTRODUCTION

On November 2, 2007, the parties and interveners submitted a Joint Statement of the Parties and Intervenors Re: Meet and Confer. In this statement, the parties entered into a stipulation to bifurcate the hearing into two phases. Phase I would consist of a hearing to determine whether appellants were overfunded by as much as \$38 million as a result of alleged incorrect Full-Time-Equivalency (FTE) calculations.¹ The administrative law judge would issue factual findings and legal conclusions on this issue. Phase II of the hearing would include all other issues of the appeals of the Extraordinary Audit and Follow-up Audit.

On March 20, 2008, the administrative law judge issued a ruling consisting of Factual Findings and Legal Conclusions for Phase I. The ruling included discussions regarding appropriate calculations of FTEs, and whether incorrect calculations of FTEs resulted in public overfunding of appellants OFY and OPL. The administrative law judge concluded that: (1) appellants were not entitled to claim more than 1.0 FTE for each full-time certificated teacher; and (2) cause existed to overrule the auditors' findings that appellant's may have been overfunded because of incorrect FTE calculations. This ruling was not a proposed decision pursuant to Government Code section 11517.

On March 12, 2010, the administrative law judge issued an order granting Intervenors' Motion to Vacate and Set Aside Findings and Legal Conclusions on the Issue of Overfunding on Phase I. In this ruling, the administrative law judge reopened the record for Phase I and admitted the declaration of Mr. Greg Geeting. Appellants were given the opportunity to cross-examine Mr. Geeting and the matter was set for further hearing on December 1, 2010. On November 29, 2010, appellants waived their right to cross-examine Mr. Geeting and the matter was submitted for reconsideration.

¹ A full-time equivalent (FTE) is a basic unit of employment for teachers. A teacher who teaches full-time is considered one FTE.

FACTUAL FINDINGS

AUDITS OF OFY AND OFL

1. Appellants OFY and OFL operate a number of independent study charter schools throughout California. Charter schools in this state are governed by the Charter School Act (CSA), which is set forth in Education Code section 47600 et seq.

2. In March 2005, the California Department of Education (CDE), along with certain county offices of education, initiated an audit of certain OFY and OFL charter schools.

3. In August 2006, an Extraordinary Audit was performed on the charter schools operated by appellants OFY and OFL. The audit covered fiscal years 2002/2003 through 2004/2005. The audit report consists of four separate chapters that included certain findings and recommendations. In 2007, a follow-up audit was performed which included responses to the Extraordinary Audit submitted by appellants. OFY and OFL appealed the findings and recommendations of the audit. The parties previously agreed that the issues raised in Chapter Two of the audit would not be litigated in these proceedings before EAAP.

CHARTER SCHOOL FUNDING

4. Similar to public schools, OFY and OFL charter schools receive funding from CDE based on the average daily attendance (ADA) of the charter schools. Schools may claim ADA based on the aggregate attendance of students during each reporting period. For example, one student who attends school each day for the entire reporting period equals 1.0 ADA. The higher the ADA for a program, the greater the amount of funds it will receive from the state.

5. School districts and charter schools calculate ADA and report it to CDE. After the charter schools report their ADA to CDE, the State Superintendent of Public Instruction apportions state school funds to the charter schools. The source of the ADA data reviewed by the audit team to determine the appropriateness of the charter school funding was from the charter schools' annual audited financial statements.

6. Senate Bill No. 740 (2001-2002 regular session Chapter 892) (SB 740) amended the CSA. Pursuant to SB 740, the Legislature directed and authorized the State Board of Education (SBE) to establish criteria to evaluate funding requests from charter schools offering non-classroom-based instruction, and to determine the total amount of funding that each non-classroom-based charter school should receive.

7. Under the new legislation, when applying for funding, independent study charter schools, such as those operated by OFY and OFL, must submit a Non-Classroom-Based SB 740 Funding Determination form (SB 740 form). Charter schools must report revenues and expenditures and may be eligible for either partial or full funding depending on the ratio of expenditures to revenues for selected items. SBE uses this data as a basis for making its determination of the percentage of funding that the school is eligible to receive in the upcoming year. For instance, the SB 740 form used to determine funding levels for 2005-2006 is based on actual financial data from the 2004-2005 school year.

8. In 2003, SBE adopted regulations which set forth requirements for determining funding levels for non-classroom-based instruction provided by charter schools. Pursuant to these regulations, which are set forth in detail below, 100 percent funding is available to a charter school if its ratios of certain expenses to revenues meet specific thresholds and their pupil-to-teacher ratio (PTR) meets stated minimum threshold requirements. PTR is generally calculated by dividing the total ADA by the total number of full-time equivalent (FTE) teachers. If a charter school's PTR does not meet the specific levels stated in the regulations, it can still receive partial funding, usually determined as a reduced percentage of the total available funding. OFY and OFL charter schools received 70 percent of available funding for the 2003-2004 school year.

9. Charter schools are ineligible for funding if they do not spend at least 35 percent of their total public revenues on certificated teachers or 60 percent of total public revenues on instruction and related services.

APPELLANTS' FUNDING APPLICATIONS

10. During the relevant years that were the subject of the audit, OFY and OFL submitted applications for funding to SBE. Their applications included information on revenues, expenses, ADA, and teacher FTEs.

11. For the purpose of calculating PTR, OFY and OFL utilized a formula whereby a full-time teaching assignment at their schools resulted in a 1.92 FTE. In essence, appellants arrived at the 1.92 FTE by dividing annual instruction time specified in their teacher contracts (1,680 hours) by the annual instruction time of teachers in the school district where they are located (875 hours). OFY and OFL contended that the teachers of their charter schools work more days and hours than a "typical" teacher due to their year-round calendar and longer school day. They also asserted that numerous other schools throughout California claim FTE greater than 1.0. To determine whether the 1.92 methodology is permissible under existing laws and regulations, the audit team sought a legal opinion from CDE's attorneys. The CDE's attorney opined that the 1.92 methodology does not comply with existing laws and regulations and that the charters should claim their teachers on a 1.0 FTE scale. OFY and OFL disputed this legal opinion.

12. Interveners contend that OFY and OFL improperly calculated the number of FTE certificated teachers for inclusion in the PTRs. Moreover, the auditors determined that some charters could not support the FTE claimed, made errors in their calculations of PTRs, double-counted teachers, and included unallowable staff in their FTE calculations. Because of these alleged errors, the auditors concluded that both OFY and OFL may have received excess funding from the state.

DISCUSSION RE: FULL-TIME EQUIVALENT

13. One of the issues decided in Phase I of the hearing was whether appellants OFY and OFL could properly claim a 1.92 FTE for each full-time certificated teacher. Appellants contend that since their teachers are required to work almost twice as many hours per year (1,680 hours per year pursuant to their employment contracts) as full time teachers in traditional public schools (875), they should be allowed to claim 1.92 FTE for each full time teacher. The undersigned ruled in the original Legal Conclusions for Phase I that appellants OFY and OFL did not establish that they are entitled to claim more than 1.0 FTE for each full-time certificated teacher who teaches at their independent study charter schools. This ruling was not part of Interveners' motion and remains in effect.

DISCUSSION RE: OVERFUNDING

14. SB 740 amended Education Code sections 47605 and 47612.5, and added sections 47614.5, 47616.7 and 47634.2. Among other things, these statutes addressed funding requirements for independent study, non-classroom based charter schools.

15. Prior to the enactment of SB 740, the section 47612.5, subdivision (b), stated:

(b) Notwithstanding any other provision of law, a charter school shall comply with Article 5.5 (commencing with section 51745) of Chapter 5 of Part 28 and implementing regulations adopted thereunder. . . .

16 (A). The original language of Education Code section 47612.5 set forth above required independent study charter schools to comply with the PTRs set forth in Education Code section 51745.6, subdivision (a), which requires PTRs for district independent study programs to be equal to or less than the PTR for all other educational programs operated by the district. In addition, subdivision (a) requires PTRs for county independent study programs to be equal to or less than the PTRs of all other educational programs operated by the largest high school or unified school district in that county. Subdivision (e) gives a charter school the option to apply a fixed PTR of 25 pupils per certificated employee (25:1).

16 (B). Under section 51745.6, subdivision (b), schools with independent study programs are not prohibited from serving additional units of average daily attendance (ADA), but only those units of ADA that comply with the PTR ratios set forth in subdivision (a) are eligible for apportionment. The additional units of ADA are not funded.

17. With the passage of SB 740, section 47612.5 was amended to state as follows:

(b) Notwithstanding any other provision of law, **and except to the extent inconsistent with this Section and Section 47634.2,** a charter school that provides independent study shall comply with Article 5.5. (Commencing with Section 51745) of Chapter 5 of Part 28 **and the implementing regulations adopted thereunder.** [Emphasis added.]

[¶] . . . [¶]

(d)(1) Notwithstanding any other provision of law . . . a charter school that has an approved charter may receive funding for nonclassroom-based instruction **only** if a determination is made pursuant to Section 47634.2 by the State Board of Education. **The determination for funding shall be subject to any conditions or limitations the State Board of Education may prescribe. The State Board of Education shall adopt regulations on or before February 1, 2002, that define and establish general rules governing nonclassroom-based instruction that apply to all charter schools and to the process for determining funding for nonclassroom-based charter schools offering nonclassroom-based instruction** other than the nonclassroom-based instruction allowed by paragraph (1) of subdivision (c). . . (Emphasis added.)

18. The newly adopted Education Code section 47634.2 mandated that criteria for funding adjustments for independent study charter schools include, among other things, the schools' PTRs. Section 47634.2 also directed the SBE to adopt regulations setting forth criteria for funding of non-classroom-based instruction at charter schools. It further directed SBE to appoint an advisory committee to recommend criteria for funding in accordance with section 47634.2. The Advisory Commission on Charter Schools (Advisory Commission) was chosen by SBE to make recommendations on funding criteria. Section 47634.2 states in pertinent part:

(a)(1) Notwithstanding any other provision of law, the amount of **funding to be allocated to a charter school on the basis of average daily attendance that is generated by pupils engaged in nonclassroom based instruction**, as defined by paragraph (2) of subdivision (d) of Section 47612.5, including funding provided on the basis of average daily attendance pursuant to Sections 47613.1, 47633, 47634, and 47664, **shall be adjusted by the State Board of Education**. The State Board of Education shall adopt regulations setting forth criteria for the determination of funding for nonclassroom based instruction. . . . In developing these criteria and determining the amount of funding to be allocated to a charter school pursuant to this section, the State Board of Education **shall consider**, among other factors it deems appropriate, the amount of the total budget expended on certificated employee salaries and benefits and on school sites, as defined in paragraph (3) of subdivision (d) of Section 47612.5, **and the teacher-to-pupil ratio in the school**. (Emphasis added)

[¶] . . . [¶]

(b)(3) The determination for funding shall be on a percentage basis and the superintendent shall implement the determination for funding by reducing the charter school's reported average daily attendance by the determination for funding percentage specified by the State Board of Education.

(b)(4) If the State Board of Education denies a request for a determination for funding or provides for a reduction as authorized by subdivision (a), the board shall, in writing, give the reasons for its denial or reduction, and if appropriate, may describe how any deficiencies or problems may be addressed.

19. The language of Education Code section 47634.2, subdivision (a)(1), provides SBE with discretion to "adjust" the amount of funding for non-classroom-based charter schools. But the basis for funding allocations for such schools continues to be the computation of ADA. Further, the Legislature directed the SBE to adopt regulations that set forth criteria for funding that included, at minimum, certain expenditures **and** the PTR of the school. In enacting Education Code section 47634.2, the Legislature intended to provide for additional funding criteria for independent study charter schools that would lead to greater accountability, not to supplant the ADA basis for funding. Therefore, Education Code section 51745.6 continues to apply to non-classroom-based charter schools.

20. The legislative history of SB 740 supports the above interpretation of Education Code sections 47612.5 and 47634.2. The "Summary" of the Senate deliberative process states in section 7:

Requires the amount of funding to be allocated to a charter school on the basis of ADA that is generated by pupils engaged in non-classroom-based instruction and states that it will be adjusted by SBE.

(a) Requires SBE to adopt regulations setting forth criteria for the determination of funding for non-classroom-based instruction and at a minimum the regulation must specify that the instruction is conducted for the instructional benefit of the student. In developing these criteria and determining the amount of funding to be allocated to a charter school pursuant to this legislation, SBE must consider, among other factors it deems appropriate, the amount of total budget expended on certificated employee salaries and benefits and on school sites, and the teacher-to-pupil ratio in the school. (Senate Third Reading, As Amended September 12, 2001.)

21. Regulatory support for the position that Education Code section 51745.6 continues to be applicable to non-classroom based charter schools is found in California Code of Regulations (regulations), title 5, section 11704, which provides for a maximum PTR of 25:1 for independent study programs in charter schools; or a maximum PTR that "does not exceed the PTR for all other educational programs operated by the largest unified school district, as measured by the average daily attendance, in the county or counties in which the charter school operates. Units of independent study that are ineligible for apportionment as provided in subdivision (b) of Education Code section 51745.6, shall also be ineligible for funding pursuant to Chapter 6 (commencing with section 47630) of Part 26.8 of the Education Code."

22. Additional support for the above analysis is found in regulation section 11963.1, which states: "This article does not change the requirement that nonclassroom-based charter schools comply with the provisions of Article 5.5 (commencing with section 51745) of Chapter 5 of Part 28 of the Education Code." The language of section 11963.1 supports Interveners' contention that the adoption of regulation section 11963.4 was never intended to supplant or supersede the PTR requirements set forth in Education Code section 51745.6.

23. Although not generally recognized as a factor in determining legislative intent, the signing statement of the Governor provides context and gives more insight into the reason for the passage of SB 740. This statement, which is consistent with the above analysis and the Senate Summary, provides in pertinent part:

I am signing Senate Bill 740 which would authorize the State Board of Education to appropriately adjust funding per student for non-classroom-based charter schools. . . . [T]he current charter school funding provisions in current law provide more funding than necessary for non-classroom based instructional methods. This bill would allow the State Board of Education to assign funding rates for non-classroom-based charter school programs that are more consistent with cost-based characteristics of the instructional program employed. Furthermore, this bill would lead to greater accountability and better instructional services by encouraging classroom-based instruction among charter schools. (Historical and Statutory Notes, Education Code section 47605)

24. In 2003, the SBE adopted the funding regulations for non-classroom-based charter schools which are set forth in regulation section 11963, et seq. Regulation section 11963.4 sets forth specific funding requirements, and states in pertinent part:

(a) When a complete determination of funding request is received from a charter school, it shall be reviewed by the California Department of Education and presented to the Advisory Commission on Charter Schools, along with credible information pertaining to the request obtained from any other source. The Advisory Commission shall develop a recommendation pursuant to this section to the State Board of Education regarding the request, and that recommendation shall be presented to the State Board of Education by the California Department of Education. The following criteria shall guide the process of reviewing and developing a recommendation on the request. The California Department of Education shall report any difference of opinion between the California Department of Education and the Advisory Commission as to the recommendation presented to the State Board of Education.

(1) If the percentage calculated pursuant to paragraph (1) of subdivision (c) of section 11963.3 equals at least 35 percent but less than 40 percent, and the percentage calculated pursuant to paragraph (2) of subdivision (c) of section 11963.3 equals at least 60 percent but less than 70 percent, the Advisory Commission on Charter Schools shall recommend to the State Board of Education approval of the request at 70 percent, unless there is a reasonable basis to recommend otherwise. If the recommended percentage is lower than the requested percentage, the recommendation to the State Board shall include the reasons justifying the reduction and, if appropriate, describe how any deficiencies or problems may be addressed by the charter school.

(2) If the percentage calculated pursuant to paragraph (1) of subdivision (c) of section 11963.3 equals or exceeds 40 percent, and the percentage calculated pursuant to paragraph (2) of subdivision (c) of section 11963.3 equals at least 70 percent but less than 80 percent, the Advisory Commission on Charter Schools shall recommend to the State Board of Education approval of the request at 85 percent, unless there is a reasonable basis to recommend otherwise. The recommendation to the State Board shall include the reasons justifying a percentage that is greater than 70 percent and, if the recommended percentage is lower than the requested percentage, the reasons justifying the reduction and, if appropriate, describe how any deficiencies or problems may be addressed by the charter school.

(3) If the percentage calculated pursuant to paragraph (1) of subdivision (c) of section 11963.3 equals or exceeds 40 percent, the percentage calculated pursuant to paragraph (2) of subdivision (c) of section 11963.3 equals or exceeds 80 percent, and the ratio of average daily attendance for independent study pupils to full-time certificated employees responsible for independent study does not exceed a pupil-teacher ratio of 25:1 or the equivalent ratio of pupils to full-time certificated employees for all other educational programs operated by the largest unified school district, as measured by average daily attendance, in the county or counties in which the charter school operates, the Advisory Commission on Charter Schools shall recommend to the State Board of Education approval of the request at 100 percent (i.e. full funding), unless there is a reasonable basis to recommend otherwise. If the recommended percentage is lower than the requested percentage, the recommendation to the State Board shall include the reasons justifying the reduction and, if appropriate, describe how any deficiencies or problems may be addressed by the charter school.

25. The reference to "percentage calculated" in regulation section 11963.4 is to the ratio of credentialed teacher salaries and total expenditures for instruction, to public revenue received by the charter school (See Cal. Code of Regs., tit. 5, § 11963.3) set forth as follows:

(A) Under regulation section 11963.4, subdivision (a)(1), if teacher salaries for an independent study charter school are between 35 percent and 40 percent of total public revenue, and total expenditures for instruction are between 60 percent and 70 percent of total public revenue, that school is eligible to receive 70 percent funding "unless there is a reasonable basis to recommend otherwise."

//

(B) Under subdivision (a)(2), if teacher salary expenditures are over 40 percent and expenditures for instruction are between 70 and 80 percent of total public revenue, the school is eligible to receive 85 percent funding "unless there is a reasonable basis to recommend otherwise."

(C) Under subdivision (a)(3), a non-classroom-based charter school is eligible to receive 100 percent funding if teacher salaries are at least 40 percent of total public revenue; expenditures for instruction are at least 80 percent of total public revenue; and the PTR of an independent study charter school does not exceed 25:1, or the equivalent PTR for all other educational programs operated by the largest school district in the county in which the charter school operates. However, even if a charter school meets the percentage and PTR requirements set forth in subdivision (a)(3), the Advisory Commission still has the discretion to recommend reduced funding (less than 100 percent) if there is a reasonable basis to do so.

(D) Once the Advisory Commission arrives at a recommended funding level, it presents this recommendation to the California Department of Education (CDE) which in turn reviews the recommendation and presents it to the SBE, along with any difference of opinion it might have with the recommended funding.

26. In this case, appellants submitted requests for funding for the 2003/2004 school year. In connection with the requests, appellants supplied information on average daily attendance along with an assigned 1.92 FTE for each certificated full-time teacher. It is assumed that these funding requests went through the review process as there was no evidence to indicate otherwise. Thereafter, the SBE authorized the funding at 70 percent.

LEGAL CONCLUSIONS RE: OVERFUNDING

27. The funding limitations set forth in Education Code section 51745.6 continue to apply to non-classroom-based charter schools after passage of SB 740 and the subsequent adoption of funding regulations by SBE. To rule otherwise would allow a non-classroom based charter school to have an unlimited PTR and still receive 85 percent funding under regulation section 11963.4, subdivision (a)(2). Such an interpretation would be against public policy and conflict with the enabling statutes.

28. Appellants may have been overfunded pursuant to Education Code sections 47612.5, 47634.2 and 51745.6 as a result of the inappropriate 1.92 FTE assignments for each certificated teacher who taught at their non-classroom-based charter schools. However, the record has not been sufficiently developed to determine an exact dollar amount of overfunding resulting from these incorrect FTE calculations. The amount of overfunding will be the subject of Phase II of the hearing.

EAAP JURISDICTION OVER SB 740 FUNDING ISSUES

29. Interveners are again requesting the administrative law judge to dismiss the appeals by OFL regarding the SB 740 related findings of Chapter 3 of the Extraordinary Audit and to the SB 740 related findings of the Follow-Up Audit. Interveners cite the precedential decision *In the Matter of Gorman Learning Center*, Case No. 07-05 (Decided by EAAP in December 16, 2008) in support of their position. In *Gorman*, the EAAP did not specifically state that it lacked jurisdiction to hear appeals of audit findings relating to SB 740 funding determinations. The EAAP concluded that it had “no authority to determine whether a charter school may be “required to repay” any amount as a result of audit findings related to the information submitted to SBE on the charter school’s SB 740 funding determination request.”

30. Education Code section 41344.1, subdivision (b), authorizes EAAP to hear appeals such as those filed by appellants in the instant case. Education Code sections 41344, subdivision (d) and 41344.1, subdivision (b), do not limit the jurisdiction of EAAP to resolve alleged violations of statutes and regulations that are conditions of apportionment. Rather, section 41344, subdivision (d), provides that the extent of the audit could include “all or any part of the operations of the local educational agency.” It further provides for a hearing before EAAP “at which the local educational agency may present evidence or arguments if the local educational agency believes that the final report contains **any finding** that was based on errors of fact or interpretation of law . . .” (emphasis added). In addition, section 41344.1, subdivision (b), provides that the EAAP “panel shall consider audit appeals pursuant to the administrative adjudication provisions of the Administrative Procedure Act” and “may approve settlements and make findings of fact and interpretations of law.”

31. The EAAP adopted regulations which set forth rules governing the audit and appeals process. Regulation section 19815 delineates the requirements and the format of an audit report. Regulation section 19853, entitled Determination of Funding for Nonclassroom-Based Instruction, directs the auditor to “verify the accuracy of data submitted by the charter school to the Department of Education on the nonclassroom-based funding determination form applicable to the year being audited.” If the auditor identifies any such inaccurate data, subdivision (d) of this regulation directs the auditor to “prepare a schedule displaying the inaccurate data” and to “include the schedule in the Findings and Recommendations section of the audit report.”

32. The EAAP has set forth the requirements and components of an audit report in its regulations. The EAAP has also directed the auditor to verify the SB 740 data submitted by appellants, and to identify inaccuracies in the submitted data. Further, the EAAP has directed the auditor to include a schedule of these inaccuracies in the Findings and Recommendations of the audit report. Therefore, any inaccuracies identified by the auditor of the data submitted by appellant OFL to the Department of Education for SB 740 funding

determinations are considered "Findings" under both Regulation section 19853, and Education Code section 41344, subdivision (d). As a result, these "Findings" are appealable under section 41344, and unless previously litigated and decided in these proceedings, appellant OFL is allowed to present evidence or argument to support its contention that the alleged inaccuracies in their SB 740 submissions are based on errors of fact or interpretations of law. Further, after a hearing on the merits the EAAP may make factual findings and legal conclusions regarding the accuracy of the SB 740 data submitted by OFL even if EAAP does not have the authority to order repayment of any overfunded amounts.

33. Based on the above analysis, and for the reasons set forth in the June 22, 2007 Order issued by the administrative law judge, Interveners' motion to dismiss the appeal by OFL of the SB 740 related findings of Chapter 3 of the Extraordinary Audit and to the SB 740 related findings of the Follow-Up Audit is denied.

ORDER

Based on the above Factual Findings, Discussion and Legal Conclusions, the parties shall confer and schedule a date for a conference with the administrative law judge to discuss and to determine the exact issues to be litigated in Phase II of this hearing

DATED: March 3, 2011

Original Signed
HUMBERTO FLORES
Administrative Law Judge
Office of Administrative Hearings